PRIVY COUNCIL REPORT

LAHAD DATU TIMBER SENDIRIAN BERHAD v. DIRECTOR-GENERAL OF INLAND REVENUE

[Privy Council (Lord Diplock, Lord Russell of Killowen, Lord Keith of Kinkel, Lord Bridge of Harwich & Sir John Megaw) April 29, 1981]

[Privy Council Appeal No. 28 of 1978]

Revenue Law — Income Tax — Profits from extraction of timber — Agency fee — Timber Profits Tax — Findings of fact by Special Commissioners — Deductions for development cost, planting payments and commission — Income Tax Act, 1967, ss. 33(1) & 39(1)(g) — Supplementary Income Tax Act, 1967, ss. 19 & 20.

This was an appeal from the decision of the Federal Court reported in [1978] 1 M.L.J. 203. The facts in the case were that a parcel of state land in Sabah of approximately 4,364 acres was alienated to a co-operative society for agricultural development. The Society was also given a timber licence with rights to extract, remove and sell the timber. The society entered into two agreements with the appellants whereby the appellants undertook to fell and cut the timber and to sell and export it. The appellants in turn entered into an agreement with Yong Brothers under which they were to fell the timber and remove and sell them. The proceeds of the sale were to be collected by Yong Brothers. After they had deducted the extraction charges of 82 cts. per cubic feet and the commission on sale of 2% they would pay the balance to the appellants.

In the accounts for the year ending the 31st December 1968 (year of assessment 1969) the appellants showed the receipt of 'agency fee' as follows:—

Proceeds from sale of timber		$1,789,645.59
Less		
Royalty	$300,380.69	
Fixed commission paid to society	$140,175.54	
Extraction fee at $1.00 per cubic foot	$686,775.70	
Planting payments	$201,000.00	
Development cost	$158,000.00	$1,486,331.93
		$ 303,313.66

The two issues in this case were (1) whether the sum of $303,313.66 described as agency fee was liable to timber profits tax under the Supplementary Income Tax Act, 1967; and (2) whether the three sums described as development cost, planting payments and commission were allowable deductions in the ascertainment of the adjusted income of the appellants.

The Special Commissioners held that the sum of $303,313.66 described as agency fee was liable to timber profits tax under section 20 of the Supplementary Income Tax Act, 1967. They found that the appellant company did not carry out an agency business but what happened was that the rights under the licence were assigned by the society to the appellants. The Special Commissioners also found that the three sums claimed as deductions were not expenses wholly incurred in the production of the gross income of the appellants. They said the three sums were paid for the use of the licence or permit to extract timber within the meaning of section 39(1)(g) of the Income Tax Act, 1967. On appeal to the High Court of Borneo on a case stated the appellants' appeal was allowed. On appeal therefrom by the respondent, the Federal Court allowed the appeal and reinstated the decision of the Special Commissioners. The appellants appealed to the Yang di Pertuan Agong.

Held, dismissing the appeal: (1) in this case by their contract with the Society the appellants took over the position of the society, albeit without an express assignment of the society's rights and obligations against and to the Government, and in exchange agreed to pay the stated commission to the Society. The proceeds of the sale of timber to which the appellants became entitled are aptly described as income derived from timber operations;

(2) the three items disallowed as deductions by the Special Commissioners fell squarely within the description of sums payable for the use of a licence or permit to extract timber within section 39(1)(g) of the Income Tax Act, 1967;

(3) the conclusions of the Special Commissioners in this case were therefore correct.

PRIVY COUNCIL APPEAL FROM MALAYSIA.

Andrew Park Q.C. (*S. Woodhull* with him) for the appellants.

Patrick Medd Q.C. (*David Railton* with him) for the respondents.

Lord Russell of Killowen (delivering the judgment of the Board): The appellant company ("the taxpayer") received in July 1971 and December 1973 notices of additional assessment in respect of the year 1969, based on profits in the year 1968. The taxpayer appealed against the assessment to the Special Commissioners who in July 1974 dismissed the appeal. On appeal to the High Court of Borneo (Yusoff J.) on a case stated by the Special Commissioners the taxpayer's appeal was in June 1976 allowed. On appeal therefrom by the Inland Revenue the Federal Court of Malaysia (Lee Hun Hoe C.J. Borneo, Ong F.J. and Ho J.) in December 1977 allowed the appeal and reinstated the decision of the Special Commissioners. The taxpayer now appeals from that last order to His Majesty the Yang di-Pertuan Agong.

The issues arising on the appeal concern the questions (a) Whether a sum of $303,313 described in the taxpayer's accounts as "agency fee" was chargeable to timber profits tax under the Supplementary Income Tax Act 1967 (Act 54 of the Laws of Malaysia) and (b) Whether three sums of $158,000, $201,000 and $140,175 so described as, respectively, "development cost", "planting payments" and "commission" were allowable deductions in the ascertainment of the adjusted income of the taxpayer from timber operations.

The statutory provisions to be borne in mind when considering this appeal are the following:—

1. *Section 33(1) of the Income Tax Act, 1967 (Act 53 of the Laws of Malaysia)*

"Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for the period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source...."

2. *Section 39(1)(g) of the Act 53*

"Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of...(g) any sum, by whatever name called, payable (otherwise than to a State Government) for the use of a licence or permit to extract timber from a forest in Malaysia...."

3. *Sections 20 and 19 of the Act 54*

"20. A supplementary income tax (to be known as timber profits tax) shall be charged for each year of assessment upon the income of any person derived from timber operations at the rates specified in this Part and shall be additional to the income tax (if any) charged in respect of that person for that year of assessment under [Act 53].

19. In this Part [i.e. Part IV headed Timber Profits Tax], unless the context otherwise requires —

'timber operations' means the extraction of timber from a forest in Malaysia or the granting or assignment of any rights, privileges, licences or concessions (by whatever name called) for the extraction of such timber but does not include the processing, milling, sawing or manufacturing of the timber.

'income derived from timber operations' includes all premiums, rents and tributes (by whatever name called) derived from timber operations, or from the granting or assignment of any rights, privileges, licences or concessions (by whatever name called) for the extraction of timber from a forest in Malaysia."

The above statutory provisions were the only ones to which the attention of their Lordships was called by counsel for the taxpayer as material to the issues in this appeal. Counsel for the Inland Revenue was not called upon.

The extraction of timber for export sale is a very important aspect of the local economy. The timber trees when felled, in often remote forest areas, are sawed into manageable logs for transport by one means or another to log ponds at the sea, whence they are removed to ships for export. (Counsel for the taxpayer disclaimed any suggestion that such sawing was within that word as used in the quoted definition of timber operations.) Extraction of timber from a forest in the limited sense of felling a tree and moving it to a point outside the limits of that forest is not an end in itself: its only purpose is to achieve the sale of the timber: it is to that end that logs formed from the timber are transported sometimes many miles to a suitable log pond and then to a ship.

In early 1966 a parcel of State land of 4364 acres was alienated by the State to the Ulu Tungku Co-operative Land Development Society Ltd. ("the Society") for the purpose of agricultural development, and at the same time the Society was granted by the State Government a timber licence to extract, remove and sell the timber, the Society to apply the proceeds to development of the alienated land. In September 1966 the Society entered into an agreement with Dato Donald Stephens and Abdul Majid Khan bin Haji Kalakhan: this was not produced before the Special Commissioners (though the latter gentleman gave evidence) and the only knowledge of it—incomplete—is that it is referred to as a "timber extraction" contract in a paragraph in the objects clause of the taxpayer, which paragraph indicated that it was an object of the taxpayer to take over the position of the two named gentlemen under the contract. They in December 1966 caused the incorporation of the taxpayer. In the event it seems that that object clause was not pursued, though it cannot in their Lordships' opinion be doubted that in some shape or form and on some terms the missing contract provided for both extraction of felled timber and sale of the resultant logs.

The missing contract not having been taken over by the taxpayer, it was cancelled by clause 11 of the first agreement next mentioned: it was there referred to as an agreement entered into with the taxpayer. The first agreement was signed by Stephens and Majid Khan on behalf of the taxpayer. The Society and the taxpayer instead entered into two agreements dated June 13, 1967.

One agreement was referred to as an agreement for the extraction of timber for part of the land alienated to the Society. It was agreed that the Society should permit the taxpayer to fell and cut timber from specified blocks and to remove the timber to a log pond to be agreed. The taxpayer (described as the Contractor) was to be paid by the Society $1 per cubic foot as soon as measured by the Forest Department and delivered to the log pond. Access to the land was to be afforded by the Society to the taxpayer for the purpose of the latter's operations. Clause 8 provided that the agreement might be terminated by the taxpayer giving one month's notice to the Society. Extraction was to be completed within 4 years.

The second agreement was referred to as an agreement for timber export and the execution of certain works. It recited that the Society was desirous of entering into an agreement with the taxpayer "for the sale of the timber on the Society's behalf and for certain works to be undertaken in the development of the land". It was agreed that the Society would permit the taxpayer to "sell and export on behalf of the Society all timber extracted and delivered at an agreed log pond". Clause 2(1) put upon the taxpayer the responsibility of keeping the log pond in order, and of receiving and of custody of timber therein, and for the transport of the timber therefrom to ships. Clause 2(2) bound the taxpayer to "pay for the timber extracted and delivered to the log pond as may be due to any contractor from the Society". Their Lordships recall that the taxpayer was itself the contractor entitled to $1 per cubic foot delivered to the log pond, so this clause and the first agreement are in that regard self-cancelling. Clause 2(3) required the taxpayer to pay any royalty due to Government in respect of the timber. Clause 3 made it the duty of the taxpayer to find the best markets for sale and export of the timber and to negotiate with buyers for the best price either in the name of the Society or of the taxpayer. Clause 5 required the taxpayer to execute works specified in the Schedule at the locations specified in the attached development plan at costs not exceeding those mentioned in the Schedule: these works included road construction, construction of houses, of a school, of a teacher's quarters, of a community centre, of staff quarters, of a playing field ("padang"), and of a rest house. The total cost was some $630,000. It cannot be doubted that this was to meet the obligations of the Society under the conditions of the alienation and licence to the Society. The agreement does not specifically state that the taxpayer was to bear the cost of these works, but it was (rightly) assumed on all hands that it was to. Clause 9(1) required the taxpayer to pay to the Society or to a Contractor for the Society $587,000 by instalments not exceeding $198,000 in any one year: these payments were to cover the assessed costs of planting part of the area with coconuts and cover crops, of maintenance of the planted area for 6 months, and for twelve miles of fencing. These no doubt were obligations of the Society under the State alienation and licence to it. Clause 9(2) required the taxpayer to pay to the Society within one month of timber being sold and exported either 21 cents or 5 cents per cubic foot depending on girth. Clause 10 repeated the provisions for determination contained in the other agreement. Clause 13 gave the agreement a period of 4 years and contained a proviso "that if there is delay in the extraction and delivery of timber at the log

pond and in the execution of any work under this Agreement, which could not have been reasonably avoided by the Contractor" an extension of the 4 years might be permitted — a direct link with the other Agreement.

Their Lordships are of the clear opinion that these two agreements can only be regarded as interdependent and must be treated as one integral bargain between the two parties. (Indeed it is recited in the sub-contract dated June 28, 1967 between the taxpayer and Yong Brothers later mentioned that the taxpayer "has a contract to extract and sell timber".) It would seem likely that the device of two agreements (at an extra cost of $5) instead of one was an attempt to minimise the incidence of timber profits tax. [In that connection it was accepted before their Lordships, though not below, that the tax avoidance provisions of section 140 of the Act 53 were not available to the Revenue for lack of requisite notices under subsection (5).]

Counsel for the taxpayer, while saying that if there had truly been two separate agreements his contentions might have been easier (or less difficult), said that they were nonetheless valid had there been only one document containing the whole of the arrangements between the taxpayer and the Society. The theme of his contentions was that extraction is one thing and selling extracted timber was another for the purposes of the relevant fiscal legislation.

What in summary was the contract between the taxpayer and the Society? It was in their Lordships' opinion this. The Society had from Government the right to extract and sell timber from the designated areas, subject to obligations as to construction, planting and fencing already mentioned. The Society and the taxpayer agreed (without formal assignment of the Government licence) that the taxpayer should, directly or indirectly, exercise the Society's rights and perform the Society's obligations in exchange for payment by the taxpayer to the Society of 21 cents (or 5 cents) per cubic foot of timber extracted, sold and exported. Nothing was to be paid by the Society to the taxpayer for the work of extraction, for the $1 per cubic foot was self-cancelling. The taxpayer's gross remuneration for its work on extraction, removal to the log pond, maintenance of the log pond, and merchandising was to be the proceeds of sale, less a fixed commission to the Society per cubic foot sold, and subject to the obligation to pay for the construction of the scheduled works and to pay to the Society (or its nominated contractor) the other sums for planting, etc. by instalments not exceeding $198,000 yearly, and also the royalty due to the State.

The accounts of the taxpayer for the basis year 1968 showed Proceeds of Sale of 686,775 cubic feet of timber at $1,789,645. (All fractions are here ignored.) From that figure was deducted a figure of $1,486,331 leaving a sum of $303,313 described as "agency fee". The total of $1,486,331 was made up as follows:—

(i) Royalty (i.e. to State)	$300,380
(ii) Fixed Commission to Society	$140,175
(iii) Extraction fee at $1 per cubic foot	$686,775
(iv) Planting payments	$201,000
(v) Development cost	$158,000

Item (iii) above is of course the self-cancelling sum already mentioned: though it is a contra brought into the taxpayer's profits as extraction charges received, a sum which the taxpayer is prepared to submit to timber profits tax. The question is whether the sum of $1,789,645 (minus the figure for royalty) is for timber tax purposes chargeable from which the figures at (ii), (iv) and (v) are not deductible.

The taxpayer not having the equipment or expertise to carry out its obligations to the Society on June 28, 1967 entered into an agreement with Yong Brothers (already mentioned) whereby the taxpayer subcontracted some of its obligations to Yong Brothers. The latter at their own expense were to fell the timber and remove it to the log pond, when they were to receive 82 cents per cubic foot: they were permitted to sell the timber in the log pond as might be agreed with the taxpayer, and were to receive 2 per cent of the proceeds of sale. The Special Commissioners found that the figure of $1,789,645 mentioned above as proceeds of sale was arrived at after deduction of this 2 per cent, and that the figure of $303,313 should therefore be increased by $36,651 to $339,964. Apart from that and from the marginal relevance (see above) of its recital the Yong Brothers' agreement does not afford assistance. It will be noted that the taxpayer's liability to the Society to meet construction and planting costs was not passed on to Yong Brothers.

The Special Commissioners found (in effect) that the gross income of the taxpayer from the timber operations was $1,826,296, proceeds of sale. From this Government royalty was a permissible deduction of $300,380: if the three figures of "development costs" ($158,000), "planting payments" ($201,000) and "fixed commission" ($140,175) — a total of $499,175 — were also deductible this would leave a figure of $1,026,741: but under section 39(1)(g) of Act 53 they were not. This would leave a figure of $1,525,916.

There are it appears to their Lordships two questions for solution. The first is whether the interest of the taxpayer in the proceeds of sale enters at all into the ascertainment of its income derived from timber operations. The taxpayer contends that this is not so, and is not so even if the two agreements are to be regarded as one integral agreement. Timber operations, it was contended, is confined to the extraction of timber by felling and removal from the confines of the forest: though the taxpayer was prepared to accept that the $1 per cubic foot was such income, it was in terms consideration for log ponding as well as removal. Faced with the possible situation that the Society in this case might have done its own felling, removal and marketing, it was argued for the taxpayer that somehow the proceeds of sale should be apportioned in order to ascertain how much of them should be properly labelled income derived from timber operations. Their Lordships do not perceive upon what basis that could be done. The whole purpose and function of timber extraction is to turn it to account by export and sale, and their Lordships cannot accept the view that income derived from timber extraction is so narrowly to be construed as to exclude income from sales of which the extraction is a *sine qua non*. Of course if (in the example given) importing purchasers from the Society were to sell their

rights at a profit, their profit would not be income derived from timber extraction. That profit would derive from turning to good account a contract of purchase of timber. The extraction of timber is only in the background.

In the instant case the taxpayer by its contract with the Society took over the position of the Society, albeit without an express assignment of the Society's rights and obligations against and to Government, and in exchange agreed to pay the stated commission to the Society. Equally, it appears to their Lordships, the proceeds of sale of the timber to which the taxpayer became entitled are aptly described as income derived from timber operations.

The second question is whether the three items disallowed as deductions by the Special Commissioners come within section 39(1)(g) of the Act 53. They have already been described. They appear to their Lordships to fall squarely within the description of sums payable for the use of a licence or permit to extract timber, within that statutory provision.

In their Lordships' opinion the conclusion of the Special Commissioners was correct, and they will advise His Majesty the Yang di-Pertuan Agong that this appeal should be dismissed with costs.

Appeal dismissed.

Solicitors: *Slaughter & May; Stephenson Harwood.*

SINGAPORE REPORTS

THE FIRST NATIONAL BANK OF CHICAGO v. TAN LAI WAH

[C.A. (Wee Chong Jin C.J., Kulasekaram & Rajah JJ.) May 20, 1981]

[Singapore — Civil Appeal No. 63 of 1980]

Banking Law — Bank granting overdraft facilities — Guarantee for unlimited liability — Plea of non est factum — Plea rejected by appellate court.

Guarantee — Plea of non est factum — Plea rejected by appellate court.

The present appeal arose from a judgment of D'Cotta J. (see [1981] 1 M.L.J. 183) dismissing a claim by the appellants against the respondent for the sum of $2,520,198.91 with interest on a guarantee dated April 18, 1974 by the respondent in favour of the appellants.

The respondent had been a land broker for 17-18 years since 1962. She contended that she did not know that the document which she signed was a guarantee for an unlimited amount otherwise she would never have signed it. Her plea of *non est factum* was accepted by the lower court who dismissed the bank's claim. The bank appealed on the ground that the learned trial judge erred in fact and in law in finding that the plea of *non est factum* had been successfully established by the respondent. The latter contended that the decision of the learned trial judge ought to be affirmed. In addition she submitted that there was no consideration moving from the Bank to her for the said guarantee. She also pleaded that the plaintiffs had been guilty of laches.

Held, allowing the appeal: (1) where oral self-interested testimony is conflicting on a particular matter and there is contemporaneous or near contemporaneous documentary evidence relevant to the matter before the court, such evidence should be also given due consideration by the court, particularly if such documents came into existence long before the matter in question became one of dispute between the parties, before it makes a finding on the matter in issue; in this case regard should be had to the three documents before the court (letters dated April 22, 1974, August 8, 1974 and August 10, 1974);

(2) if the attention of the learned trial judge had been specifically directed to the said documents, he would not have held, as he did, that, in his judgment, the respondent had successfully established the plea of *non est factum*;

(3) having regard to the respondent's long experience as a land broker and other spheres of business — factors which the learned trial judge appeared to have not considered — her mere assertion that she thought the document she signed was one guaranteeing her a half share in the property was unbelievable;

(4) there was good and sufficient consideration moving from the bank to the respondent. Although it is not necessary to record in a guarantee the consideration for which it is given (section 3, Mercantile Law Amendment Act 1856) a bank guarantee usually includes a clause describing why the guarantor has undertaken the liability. The present guarantee was no exception and contained the expressions "continuing advances" and "affording banking facilities" which were quite sufficient in themselves to meet the circumstances under which the guarantee was given;

(5) there is an implied term in the contract of guarantee whereby the Bank, in whose favour the guarantee is given has a similar duty to the guarantor, as indeed it has to the mortgagor, whose property is being sold under its power of sale, to take reasonable care to obtain a proper market price. In this case there was no evidence that the property was sold at an undervalue.

Cases referred to:-

(1) *Saunders* v. *Anglia Building Society* [1970] 3 All E.R. 961.

(2) *G. Merel & Co. Ltd.* v. *Barclays Bank* (1963) 107 S.J. 542.